**ESSAY QUESTIONS**

**$$$001**

Explain and discuss the wealth maximization theory.

**$$$002**

What is the CAPM model and its implications for investment management?

**$$$003**

Discuss the concept of financial markets effectiveness, what type of market is considered the most appropriate for perfect competition?

**$$$004**

Explain and discuss the theory of optimal capital structure.

**$$$005**

Discuss the fundamentals of Agency principal theory.

**$$$006**

What are the four areas of financial management? Briefly discuss each by providing relevant examples.

**$$$007**

Explain and discuss the tradeoff of risk management theory.

**$$$008**

Explain and discuss the timeliness effect on economic value of financial assets.

**$$$009**

Why incremental cash is important for financial decisions? Explain and discuss.

**$$$010**

What are the challenges of financial management under the COVID-19? Explain and discuss.

**BLOCK 1**

###001

Define the components of the CAMELS criteria and explain how a CAMELS rating is calculated.

###002

Identify at least two problems a borrower would face if banks were not required to disclose the information that they are currently required to make available.

###003

Explain the difference(s) between a debit card and a credit card.

###004

What is included in M2 that is not included in M1?

###005

What are the four fundamental characteristics that determine the value of a financial instrument?

###006

What three strategies are employed by government officials to ensure that the risks created by the government safety net are contained?

###007

What distinguishes commodity money from fiat money?

###008

Explain the difference between a pension fund that is a defined-contribution plan from one that is a defined-benefit.

###009

What is the basic difference(s) between term and whole life insurance?

###010

What is the source of regulatory competition in banking? Discuss how the focus of this competition has changed over time.

###011

What does it mean to say the United States has a dual banking system?

###012

What is the characteristic that distinguishes money from other assets? Explain.

###013

Why do you think banks in the U.S. are prohibited from owning securities (stocks and bonds) of corporations?

###014

What are the four characteristics of a financial instrument?

###015

Briefly explain one function of financial instruments that can make them very different from money.

###016

What are the securities that U.S. banks are allowed to own and why are they often referred to as secondary reserves?

###017

One of the cash items included on the asset side of banks' balance sheets is reserves. What makes up reserves and what is their purpose?

###018

Identify the four broad categories that make up the asset side of the balance sheet for banks and which category is usually the largest.

###019

What is the Beta of the stock? Provide an example.

###020

What does it mean to say that an asset is "liquid"?

###021

Explain why non-transactions accounts have become a more important source of funds for the bank than transaction accounts over the past thirty years?

###022

What is free cash flow? Explain.

###023

What is the venture capital? Explain.

###024

What are three broad sources of cash for firms?

###025

Please explain how financial intermediaries contribute to increasing the output of an economy.

###026

What is the difference between economies of scale and economies of scope? Provide an example of each that pertains to financial institutions.

###027

What are the five functions performed by financial intermediaries?

###028

If diversification is such a good idea for a saver, why do so many people put a lot of their savings in the same bank?

###029

Explain how mutual funds offer small investors a low-cost way to achieve diversification.

###030

A bank advertises a very competitive loan interest rate. Explain how this strategy can avoid the problem of adverse selection.

###031

Discuss the role that companies like Standard & Poor's, Dun & Bradstreet, and Moody's play in solving the problem of adverse selection.

###032

Explain the difference between a secured and an unsecured loan, and the interest rate you would expect to see charged on each (all other factors equal).

###033

Explain why deflation can be so troubling to borrowers and lenders.

###034

Explain how the threat of a leveraged buyout or a takeover can actually treat the problem of moral hazard.

###035

How did information asymmetries in the home mortgage market contribute to the financial crisis of 2007-2009?

###036

Define the law of one price?

###037

What does depreciation of a domestic currency mean?

###038

Explain why the changes we observe in nominal exchange rates in the short run must be due primarily to changes in the real exchange rate.

###039

Considering the foreign exchange market, identify at least four causes for a decrease in the demand for dollars.

###040

Considering the foreign exchange market, identify four causes for an increase in the supply of dollars.

###041

Considering the foreign exchange market, specifically the market for U.S. dollars and British pounds, who is supplying dollars in this market?

###042

What is financial market?

###043

Explain how an interest rate futures contract differs from an outright purchase of a bond.

###044

What are the three main ways to categorize derivatives?

###045

What is the difference between primary and secondary markets?

###046

With a put option, what specifically does the option holder receive for the price paid for the option?

###047

What is a credit-default swap?

###048

Explain the concept of notional principal used in swaps.

###049

What do bondholders and stockholders have in common?

###050

Why is an index number valuable?

###051

What is the diversification?

###052

Does the concept of limited liability make owning stocks more or less attractive? Explain.

###053

Explain why the willingness to purchase stocks is influenced heavily by shareholders' legal rights.

###054

Why isn't the actual level of an index, for example the Dow Jones Industrial Average, very useful on its own?

###055

The Standard & Poor's 500 Index differs from the DJIA in at least two major respects. What are the two major differences?

###056

Briefly explain the different focus of valuing stocks taken by behavioralists, chartists, and those who focus on P next year.

###057

What is the main purpose (function) of bond rating services?

###058

What role did rating agencies play in the financial crisis of 2007-2009?

###059

What is meant by a subprime mortgage?

###060

How did asset backed commercial paper (ABCP) rollover risk contribute to the financial crisis of 2007-2009?

###061

In early 2001 the stock market in the U.S. suffered significant losses. What impact should this have had on the bond market and why?

###062

Which core principle(s) could you use to explain why credit card issuers charge such high rates of interest?

###063

How do central banks, like the U.S. Federal Reserve, contribute to the welfare of a society?

###064

What is the primary function of U.S. regulatory agencies in the U.S. financial system?

###065

Identify the six parts of the financial system.

###066

Identify the five core principles of Money and Banking.

**BLOCK 2**

###001

Explain why depository institutions receive a disproportionate amount of attention from government regulators (compared to most other industries).

###002

What is the relationship between financial market development and economic growth?

###003

Why are banks restricted in the assets that they can own? For example, why do you think banks are prohibited from owning common stock?

###004

If we lived in an economy where interest rates were highly volatile, would you expect the maximum asset to capital ratio that a regulator would allow to increase or decrease and why?

###005

Discuss the impact of the evolving financial system on the bank-lending channel of monetary policy transmission? Evaluate what that is likely to mean for future changes in the target federal funds rate.

###006

What are the arguments for and against monetary policymakers intervening to address equity and property price bubbles?

###007

Provide examples of direct and indirect finance and a brief explanation of the difference between the two.

###008

Why is it more correct to say that there may be correlation between high interest rates and the growth rate of output but there is no clear causation?

###009

The chapter seems to imply that the direct influence of short-term interest rate changes by central bankers is not that powerful in terms of their direct impact on spending. Why then do so many people pay attention to the monetary policy?

###010

Why are policy makers reluctant to make unconventional tools part of their regular arsenal of policy tools?

###011

What are the pros and cons of a policy of "leaning against bubbles?"

###012

What are the unconventional policy options that central bankers can use if the traditional target interest rate hits zero?

###013

Why is deflation, combined with a recessionary gap, and a zero nominal interest rate a monetary policymaker's worst nightmare?

###014

How did poor economic forecasting contribute to the high inflation experienced in the U.S. economy in the 1970s?

###015

Why can't the nominal interest rate be negative?

###016

During the 2007-2009 financial crisis, what prevented policy easing from being transmitted as usual to the real economy?

###017

Explain why a corporation may find it advantageous to undertake greater investment when the value of its stock shares increase.

###018

Explain how the asset-price channel of monetary policy works in real estate markets.

###019

What role, if any, did the accounting scandals involving some U.S. companies in 2001 and 2002 play in the supply of loans?

###020

Explain why lowering of interest rates should raise stock prices.

###021

Discuss why the interest-rate transmission mechanism of monetary policy isn't as strong as most people may think it might be.

###022

Describe the immediate short-run effect to the economy from an increase in government purchases, as well as the self-correcting mechanism that will restore long-run equilibrium.

###023

Why could it be effectively argued that the temporary increase in inflation from the spending for the Vietnam War was made permanent by the Fed?

###024

Why do negative supply shocks pose a particularly difficult dilemma for monetary policymakers?

###025

Neutralizing demand shocks is easier in theory than in practice. Why?

###026

Why is it that a run on a single bank can turn into a widespread financial panic, or what the text identified as contagion?

###027

What is the difference between a bank that is insolvent and one that is illiquid?

###028

Why might there be a trade-off between a bank's profitability and its safety?

###029

Explain why a large equipment provider that sells to many of its commercial customers on account may use a finance company.

###030

In what way(s) can a pension plan be seen as the opposite of life insurance?

###031

Which insurance companies, life or property and casualty, would you think would invest more in long-term assets? Explain.

###032

Owners and managers have cited three reasons for the creation of large financial firms or universal banks. What are these reasons?

###033

A home buyer is presented with two options for financing the purchase of a home: a 20 year fixed rate mortgage or a 20 year adjustable-rate mortgage. Which mortgage would you expect to start at the lowest interest rate and why?

###034

Information asymmetry that exists in lending creates what type of risk for banks? Discuss the ways for a bank to handle or minimize this risk.

###035

If the Federal Reserve were to do away with the required reserve regulation, do you think banks would stop holding reserves? Explain.

###036

Considering that, on average, the return on assets is the same for small and large banks, and the return on equity is higher for large banks than small banks, what can be one of the explanations for the trend toward bank mergers?

###037

Explain why a bank with a high debt-to-equity ratio may be more profitable than a bank with a lower ratio but would also have a higher level of risk.

###038

Explain why a bank manager and a bank regulator would likely view the timing at which a loan should be charged to the loan loss reserve differently.

###039

Why would a bank usually want to minimize the amount of excess reserves it has on hand?

###040

The United States, the United Kingdom, Germany and Japan are all developed countries with highly developed and efficient financial markets. However, in all four countries the main source of business finance is internal funding. Why is this so?

###041

Explain why a forward contract may carry more risk than a futures contract.

###042

Explain why the two parties in a futures contract technically do not make a bilateral agreement with each other.

###043

Explain how the clearing corporation reduces the risk it faces in the futures market through the use of margin accounts and marking-to-market.

###044

A lender obtains funds from depositors by offering short-term interest rates on savings accounts. The lender uses these funds to make longer-term installment loans. Explain how the lender might make use of the futures market to hedge the risk taken.

###045

Consider a call option; in terms of the option writer and option holder, who is the buyer? Who is the seller? Finally, who has the option? Explain.

###046

Describe the condition that would have a call option in the money. Now describe the condition that has a put option out of the money.

###047

Explain the difference between American and European options.

###048

If the option holder is the individual with the options, why is anyone an option writer?

###049

What would be the value of an option on a stock that sells at a fixed price with a standard deviation of zero? Explain.

###050

Why do government debt managers often use interest-rate swaps?

###051

Explain why being a residual claimant can increase the risk from owning stocks.

###052

You have a value-weighted index made up of two companies. One company, we will call A, has a stock price of $25 per share and there are 10,000 shares outstanding. The other company, we will call B, has a stock price of $100 per share and has 1000 shares outstanding. What will be the percentage change in the index from a 10% increase in the share price of company A? What will be the percentage change in the index from a 10% increase in the share price of company B?

###053

Compare/contrast the Nasdaq Composite Index with the Dow Jones Industrial Average.

###054

Why must caution be employed in comparing stock indexes across countries?

###055

Many small companies currently pay no dividends to their shareholders. Based on the dividend discount model, how is it possible for these stocks to sell for a positive price?

###056

If an investor wants to compare commercial paper to a corresponding risk-free investment, which security would he/she use and why?

###057

Could the holding period return ever be less than the yield to maturity? Explain.

###058

Explain why the spreads on most municipal bonds would be greater than the spread on U.S. Treasury bonds.

###059

Explain why holding period return, as an economic measure, does not have the same significance as current yield or yield to maturity.

###060

Suppose that a bond is purchased at a discount (meaning that it is sold for less than face value). Could the yield to maturity ever be less than the coupon rate? Could the holding period return be less than the coupon rate? Explain.

###061

In mid-2004 there was speculation that the Federal Reserve would be raising interest rates before the end of the year. How would this news affect the bond market and why?

###062

Countries that are economically stable tend to grow faster than those with an unstable business cycle. Why is this? How can the central bank improve conditions in the unstable countries?

###063

Why do banks usually offer higher rates of interest to savers willing to provide their savings to the bank for a longer period of time? To which core principle does this relate?

###064

Why are electronic transactions increasingly taking the place of paper transactions?

###065

What was the double liquidity shock that occurred in the US financial system in the summer of 2007?

###066

Why do economists claim the Consumer Price Index (CPI) tends to overstate the actual rate of inflation?

###067

Explain why credit cards are not considered money even though people seem to use them like money.

###068

Explain how money solves the problem of the "double coincidence of wants."

###069

Explain why the following statement is true, "money is an asset but not all assets are money."

###070

Explain the various ways that financial intermediaries increase the efficiency of an economy.

**BLOCK 3**

###001

The yield on a discount basis for a $100 Treasury bill that sells for $98.50 and matures in 90 days is?

###002

Consider a zero-coupon bond with a $1,100 payment in one year. Suppose the interest rate decreases from 10% to 8%. The price of this bond is?

###003

Calculate the holding period return for a $1,000 face value bond with a $60 annual coupon purchased for $970.00 and sold three years later for $1,060.00.

###004

You purchase a good by writing a check for $1,000. Considering the financial payments system this check follows, when is the check money? Explain.

###005

Compute the interest rate for a $1,000 face value a bond that sells for $280 and matures in 20 years. The bond has no coupon payments, only the face value payment.

###006

Define a bank's balance sheet?

###007

What should be the impact on a bank's return on assets and return on equity from increased use of off-balance-sheet activities?

###008

A bank has $100 million in assets and 50 percent of its assets are interest sensitive. The bank has $75 million in liabilities, 50 percent of which are interest sensitive. What is the bank's gap between interest-sensitive assets and liabilities?

###009

A bank has the following assets: Reserves of $15 million; Loans of $150 million; and Securities of $50 million. Their liabilities include Deposits of $150 million; Borrowed funds of $35 million and Bank Capital of $30 million. If the required reserve rate is 10 percent, answer the following: What is the amount of excess reserves the bank is currently holding? What are the options available to the bank if customers decide to withdraw $10 million in deposits?

###010

You are provided with the following information: a bank has a net income after taxes of $3.5 million; it has assets of $150 million; and bank capital of $12.5 million. What is the bank's return on assets; its return on equity, and its debt-to-equity ratio?

###011

Mergers resulting from the financial crisis of 2007-2009 have left what percentage of deposits in the hands of 4 banks?

###012

For every $100 in assets, a bank has $30 in interest-rate sensitive assets, and the other $70 in non-interest-rate sensitive assets. The same bank has $60 for every $100 in liabilities in interest-rate sensitive liabilities, the other $40 are in liabilities that are not interest-rate sensitive. If the interest rate on assets decreases from 6 to 5 percent, and the interest rate on liabilities decreases from 4 to 3, percent the impact on the bank's profits per $100 of assets will be:

###013

If a bank has deposits of $250 million, reserves that total $30 million and has a required reserve rate of 10 percent:

###014

If a bank has $200 million in deposits, the required reserve rate is 10 percent and the bank has $23 million in reserves:

###015

If a bank has $150 million in assets and a net worth of $20 million, its asset-to-equity ratio is?

###016

If a bank has $100 million in assets and a net worth of $10 million, its debt-to-equity ratio is?

###017

Suppose that a bank initially has a leverage ratio of 8 to 1. If this bank increases its capital by $1million and its assets by $10 million, then the bank's leverage ratio becomes what?

###018

If a bank has a net worth that is negative, what do you know about the relationship between the amounts the bank has in assets and liabilities?

###019

If buyers cannot distinguish quality, and on average, people value a good used car at $15,000 and a "lemon" at $5,000, explain why an average price of $10,000 for used cars will not bring the average of quality used cars to the market.

###020

Private Mortgage Insurance (PMI) is often required by mortgage lenders when the borrowers have less than a 20% down payment. Discuss the requirement of PMI to the concepts of net worth, moral hazard, and transfer of risk.

###021

What are the responsibilities of a finance manager? What qualities must s/he have in order to be a successful manager? Explain and discuss.

###022

Explain the Capital Asset Pricing Model?

###023

If a Japanese Toyota sells for 2,500,000 yen and the nominal exchange rate is 110 yen/$U.S., then the dollar price of the Japanese automobile is?

###024

A bagel cost $1 in New York and 0.5 euros in Paris. If the real exchange rate is one-half of a New York bagel for a Parisian bagel, how many euros should you receive in exchange for one dollar?

###025

When a country's current account balance is added to its capital account balance, the sum should be what?

###026

What would happen to the exchange rate of a country running a current account surplus over many years should? Why?

###027

If the Federal Reserve in the United States begins to purchase foreign currency and pay for these purchases with dollars, what impact will it have on dollar?

###028

Explain why an appreciating U.S. dollar does not benefit everyone in the U.S.

###029

Assuming the law of one price, explain what the exchange rate between U.S. dollars and yen must be if the price of steel in Japan is 15,000 yen per ton and the price in the U.S. is $125 per ton (assume no transaction costs).

###030

The price of a Big Mac in the U.S. is $2.00; the price in France is 3.35 euros. The current exchange rate is 1.05€/$. What is the real exchange rate?

###031

The same laptop computer cost $2,000 in the United States, 220,000 Japanese yen, 1,300 British pounds, and € 1900 in Germany. If the law of one price holds, what are the yen/$; GBP/$ and €/$ exchange rates?

###032

Calculate which has a higher present value: an annual payment of $100 received over 3 years or an annual payment of $50 received over 7 years. In both cases the interest rate is 7% (or 0.07).

###033

What is the monthly interest rate if you are asked to convert a 12 percent annual rate to a monthly rate (calculate to 4 decimal places)?

###034

An investment grows from $2,000 to $2,750 over the period of 10 years. What average annual growth rate will produce this result?

###035

If a country is running a current account deficit year after year, what should we expect to happen to the exchange rate for that country? Explain.

###036

Assume that currently one $U.S. will purchase GBP 0.65. Investors believe that one year from now a dollar will purchase GBP 0.72. If we consider the dollar-pound market, where the horizontal axis measure the quantity of pounds, explain what we are likely to see in terms of demand and supply and the exchange rate?

###037

If an American traveling abroad can obtain 115 euros for $100 U.S, the current euro per $ exchange rate is what?

###038

What are the benefits of going public? Explain and discuss.

###039

If the current exchange rate is 1€/1$U.S. and bagels cost 1€ in France and 1$ in the U.S. and the current exchange rate for bagels is 0.74 European bagel/1U.S. bagel and if the bagels are identical:

###040

If a Japanese Toyota sells for 2,500,000 yen and the nominal exchange rate is 110 yen/$U.S., then the dollar price of the Japanese automobile how much?

###041

We have a futures contract for the purchase of 10,000 bushels of wheat at $3.00 per bushel. If the price of wheat were to increase to $3.50, explain what happens to the parties involved in the contract in terms of marking to market. Be sure to identify who is long and short and specifically how much is transferred.

###042

What is the process that makes sure the market price of an underlying asset equals the price of a futures contract at the settlement date? Provide an example.

###043

Suppose you purchase a call option to purchase General Motors common stock at $80 per share in March. The current price of GM stock is $83 and the time value of the option is $5. What is the intrinsic value of the option? As the expiration date approaches, what will happen to the size of the time value of the option?

###044

If the current closing price of the stock of XYZ, Inc. is $87.50 and the July expiration call options with a strike price of $80 are selling for $9.45, what is the intrinsic value of the option? What is the time value of the option?

###045

If the current closing price in the stock of XYZ, Inc. is $87.50 and the July expiration put options with a strike price of $80 are selling for $1.05, what is the intrinsic value of the option? What is the option premium?

###046

Why may dividends increase value? Explain and discuss.

###047

If the Dow Jones Industrial Average is at 10,205 and it is up 4% from the previous day, what was the index at the close of the market the previous day?

###048

You start with a $1000 portfolio; it loses 50% over the next year, the following year it gains 50% in value. At the end of two years, how much is your portfolio worth?

###049

You start with a portfolio valued at $500. Over the next twelve months it loses 40%; the following year it has a gain of 30%. At the end of two years your portfolio is worth what?

###050

You have a portfolio valued at $1000. Over the next twelve months it loses 75% of its value. What return does the portfolio need to earn over the following twelve months to restore the portfolio to its original value?

###051

You have a portfolio valued at $10,000. Over the next twelve months it loses 50% of its value. What return does the portfolio need to earn over the following twelve months to be restored to its original value?

###052

A stock has an annual dividend of $10.00 and it is expected not to grow. It is believed the stock will sell for $100 one year from now, and an investor has a discount (interest) rate of 6% (0.06). The dividend discount model predicts the stock's current price should be what?

###053

A stock has a current annual dividend of $6.00 per year and it is expected to grow by 3% (0.03) a year. It is expected that two years from now the stock will sell for $90.00 a share. If the interest rate is 5% (0.05), the dividend discount model predicts the stock's current price should be what?

###054

Next year, the price of a stock is expected to be $2200 and the stock will pay a $55 dividend. The interest rate is 10%. Based on the dividend-discount model, what is the current price of this stock?

###055

The price of a stock is currently $750 and the stock will pay a $43 dividend. The interest rate is 7.5%. Based on the dividend-discount model, what is the expected price of this stock for next year?

###056

What is a stock repurchase? Discuss its potential advantages and disadvantages.

###057

How do you calculate NPV? Are there any downsides with this measure? Explain and discuss.

###058

You have a price-weighted index made up of two stocks, A and B. The price of A equals $30 and the price of B equals $70. What is the current value of this index? Also, what will be the percentage change in the index resulting from a 10 % increase only in the price of A? A 10% increase only in the price of B?

###059

Why does the Dow Jones Industrial Average have a value over 10,000 when the 30 stocks that make up the index all have values less than $200 per share?

###060

Suppose the tax rate is 25% and the taxable bond yield is 8%. What is the tax-exempt bond yield?

###061

How do we measure Beta graphically? Explain and discuss.

###062

Assume the Expectations Hypothesis regarding the term structure of interest rates is correct. If the current one-year interest rate is 3% and the expected one-year interest rate is 5%, then the current two-year interest rate should be?

###063

If a one-year bond currently yields 4% and is expected to yield 6% next year, the Liquidity Premium Theory suggests the yield today on a two-year bond will be?

###064

What is the weighted-­‐average cost of capital and how do you calculate it?

###065

If the annual interest rate is 5% (.05), the price of a one-year Treasury bill per $100 of face value would be

###066

If the annual interest rate is 5% (.05), the price of a six-month Treasury bill would be?

###067

If the annual interest rate is 5% (.05), the price of a three-month Treasury bill would be what?

###068

What is the difference between unique risk and market risk? Explain and discuss.

###069

Discuss how borrowing affects EPS?

###070

Discuss how borrowing affects risk and return?